

ORIGINAL

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PUBLIC UTILITIES
COMMISSION

2009 FEB 20 P 4: 03

FILED

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding to Investigate)
Implementing a Decoupling Mechanism for)
Hawaiian Electric Company, Inc., Hawaii)
Electric Light Company, Inc., and Maui)
Electric Company, Limited.)

DOCKET NO. 2008-0274

DIVISION OF CONSUMER ADVOCACY'S
RESPONSES TO THE NATIONAL REGULATORY RESEARCH INSTITUTE'S
SCOPING PAPER APPENDIX 2 QUESTIONS FOR THE PARTIES

Pursuant to Commission's letter, dated January 21, 2009, the Division of Consumer Advocacy submits its **RESPONSES TO THE NATIONAL REGULATORY RESEARCH INSTITUTE'S SCOPING PAPER APPENDIX 2 QUESTIONS FOR THE PARTIES** in the above docketed matter.

DATED: Honolulu, Hawaii, February 20, 2009.

Respectfully submitted,

By Catherine P. Awakuni
CATHERINE P. AWAKUNI
Executive Director

DIVISION OF CONSUMER ADVOCACY

DOCKET NO. 2008-0274

PUBLIC UTILITIES COMMISSION

**DIVISION OF CONSUMER ADVOCACY'S RESPONSES TO THE NATIONAL
REGULATORY RESEARCH INSTITUTE'S ("NRRI") SCOPING PAPER
APPENDIX 2 QUESTIONS FOR THE PARTIES**

1. Why do electric utilities need decoupling at this time? Please address decoupling needs created by the utility's rate design and Hawaii's emphasis on electricity strategies that would reduce utility sales. If possible, quantify the need.

RESPONSE: The Hawaii Electric Utilities have enjoyed persistent growth in kWh sales from the mid 1990's until about 2005. This can be observed in the pending HECO rate case for Residential Service customers (HECO-205) and Total Commercial customers (HECO-206), although similar and somewhat historical stronger growth trends exist for MECO and HELCO. Persistent kWh growth has occurred through increases in the numbers of customers served, as well as through increases in usage per average customer. Additional sales margins (revenues less energy costs) have been realized by the HECO Companies between rate cases because the utilities' present rate designs recover significant fixed costs through the energy rate elements. Growing sales margins have provided additional sources of income to the utilities in amounts that help offset any cost increases experienced between rate case test years.

These trends have recently changed. Since about 2005, the combined impact of customer funded direct conservation measures,

customer participation in HECO-sponsored DSM programs, more efficient end-use appliances, demand elasticity responses to higher energy prices, and recently depressed economic conditions, among other factors, have all contributed to a suspension or reversal of past sales trends. In its recently submitted rate case update, HECO witness T-2 submitted a revised test year 2009 kWh sales forecast of 7,487.7 gigawatthours (GWH). This amount is about 173 GWH or 2.2 percent lower than the Company's prefiled 2009 test year sales forecast and about 210 GWH lower than recorded sales in 2004. Thus, the utilities are no longer enjoying the income "boost" that has historically occurred through sales growth under current economic conditions. The negative financial impact of declining energy sales can be avoided by the utilities if decoupling rate design measures are implemented to assure recovery of intended margin revenues without regard to fluctuations or declines in actual sales volumes.

The "need" for decoupling is difficult to quantify, because future actual sales volumes will ultimately determine how much "lost" margin revenue is to be replaced by decoupling rate increases. For example, the depth of the current recession and the scope and magnitude of future recovery is a key predictor of how much benefit the HECO companies may derive from decoupling. Additionally, it is difficult to predict how and when alternative energy

strategies such as the "big wind" initiative may ultimately be implemented, particularly with highly volatile fuel prices complicating the economic analyses behind such investments. However, we can be certain that decoupling would serve to fully insulate the utilities from the risks of declining sales volumes regardless of whether such sales changes are caused by conservation, alternative supply resources, recessionary economic conditions, or demand elasticity effects. These sales risks would otherwise be absorbed by shareholders between test years if not for the implementation of decoupling.

The Consumer Advocate's support for this movement away from what has been the traditional approach to rate design in Hawaii is not solely due to the decline in sales opportunities. The introduction of decoupling is directly linked to the Hawaii Clean Energy Initiative ("HCEI") Agreement. Decoupling was a bargained for feature of that agreement, whereby significant utility and State resources would be committed to moving away from the use of imported fossil fuel to generate electricity.

1.1. Does the administration of the energy efficiency programs by a third-party administrator affect the need for and potential benefits of decoupling?

RESPONSE: Third-party administration of energy efficiency programs removes a primary argument supporting decoupling – the assumed need to

"remove the disincentive toward sales promotion normally attributed to the utility's profit motive and the effects of regulatory lag upon sales margin growth between test years. However, the Consumer Advocate agreed to work with HECO toward implementation of decoupling at this time in recognition of the Companies' strategic and financial commitments to support the clean energy initiatives during the next few years.

- 1.2. Is the need for decoupling the same on each island? Please consider the frequency in curtailments of as-available renewable generation.

RESPONSE: The Consumer Advocate has not examined the "frequency in curtailments of as-available renewable generation" in connection with the "need for decoupling." As noted hereinabove, the Consumer Advocate agreed to work with HECO toward implementation of decoupling at this time in recognition of the Companies' strategic and financial commitments to support the clean energy initiatives during the next few years.

2. Please propose a preferred decoupling methodology and in doing so, please answer these questions.

RESPONSE: The decoupling methodology that the Consumer Advocate has agreed to support in the HCEI Agreement is best described as a version of the "Total sales adjustment" approach described at page 11 of the NRRI Report. Rather than tracking only changes in

sales volumes and not adjusting for changes in costs between test years, the HCEI Agreement also provides for index-driven changes in the authorized level of margin revenue levels to account for earnings attrition that is presumed to exist and require revenue increases between rate cases. This Agreement is set forth in some detail at paragraph 28 of the HCEI Agreement and the Consumer Advocate has advanced its views of implementation details in a Conceptual Framework Proposal submitted on January 30 in this Docket. Thus, the Consumer Advocate's proposed Rate Adjustment Mechanism ("RAM"), which includes ratepayer safeguards, has been paired with decoupling to ensure not only revenue stability for the HECO Companies, but also rate increases for any inflationary pressures that may exist between test years.

2.1. Should the decoupling process decouple the utility's earnings (or revenues) from the effects of changes in weather, economic upturns/downturns, taxes, costs of financing, the utility's credit rating or other external variables? How are the sales impacts of efficiency programs segregated from these factors, and how does the commission monitor these factors going forward?

RESPONSE: The decoupling methodology that the Consumer Advocate has agreed to support as part of the HCEI Agreement would fully decouple revenues and would track all changes in sales volumes indiscriminately, for any and all of the reasons noted in this question. We have not proposed changing the cost of capital or any explicit consideration of changes in the utility's credit ratings as

part of the decoupling process, but would note that all parties retain the right to initiate formal proceedings if such factors require consideration outside of the planned three-year rate case intervals for each utility.

2.2. Does decoupling that ensures a utility's earnings associated with lost sales create a disincentive for utilities to manage these costs effectively or to invest in capital projects rather than purchase energy or other services?

RESPONSE: It is unclear what expenses or investments are being referenced as, "these costs." Decoupling itself should have little impact upon the incentives or disincentives regarding capital investments, however the implementation of a formalized rate case cycle and a RAM procedure to account for changes in capital investments could have incentive impacts that should be considered in the design of the RAM.

2.3. Does it eliminate the utility's bias against reduced sales?

RESPONSE: Decoupling, in the form envisioned in the HCEI Agreement, should cause the HECO Companies to be indifferent with regard to future kWh sales volumes because shareholders are fully insulated from all risks associated with sales changes.

2.4. Does it accurately decouple sales and earnings (i.e., reinstate authorized earnings associated with lost sales)? Please provide supporting examples and calculations that address how lost earnings are calculated.

RESPONSE: Decoupling, in the form envisioned in the HCEI Agreement, would track all changes in sales volumes and margin revenues. "Lost earnings" are to be quantified by fixing the amount of authorized margin revenues in each formal rate case proceeding and in each subsequent RAM calculation; then comparing actual recorded margin revenues to such authorized levels. The timing and mechanics of how this would occur are specified in general terms in the Conceptual Framework Proposal that was submitted by the Consumer Advocate on January 30 in this Docket. We intend to continue to work with the HECO Companies and other parties to narrow differences and develop consensus approaches, for which supporting examples and calculations can be provided in the future.

2.5. Does it encourage customers to be energy efficient?

RESPONSE: No. Decoupling, in the form envisioned in the HCEI Agreement, would track all changes in sales volumes and margin revenues. Thus, the more customers conserve energy and reduce HECO Companies' sales volumes, the higher future decoupled rates will be. A perverse outcome of decoupling and the resulting protection of utility margin revenues is that customers are financially "punished" with higher margin rates when their conservation efforts

are successful. However, when avoidance of pass through fuel costs and externalities such as environmental benefits are considered, consumer should still benefit from their conservation efforts.

2.6. Is it easy to understand?

RESPONSE: Decoupling is not likely to be well understood or accepted by utility customers. Customers may not understand the rationale behind systematically raising utility prices when kWh sales volumes decline.

2.7. Are Hawaii's electric utilities' existing metering and customer service systems adequate to support decoupling? If no, recommend enhancements.

RESPONSE: Decoupling, in the form envisioned in the HCEI Agreement, is primarily an accounting and ratemaking exercise that is not dependent upon enhanced metering or customer service system for support. Instead, the incremental cost and effort will be upon the utility's regulatory personnel and the Consumer Advocate, Commission and other intervenors to prepare, evaluate and respond to several additional periodic filings and proposed rate adjustments each year. The only customer service impacts may arise from inquiries regarding changes to the form and content of

the monthly bills with any new line item charges that need to be explained.

2.8. Is it easy to administer (monitoring, audits, hearings, reconciliation)? Estimate the administrative costs including regulatory costs.

RESPONSE: No. The decoupling and RAM adjustments rate adjustments in the form envisioned in the HCEI Agreement are inherently complex and may entail significant incremental administrative costs to calculate, audit and reconcile, unless the parties to this Docket are successful in simplifying the methodologies to be employed within any jointly proposed framework. The Consumer Advocate has not prepared any estimates of administrative costs it may incur at this time and cannot determine how the Commission or other parties may elect to focus resources upon the potentially large rate changes that may result from decoupling and RAM procedures.

2.9. If the proposed method herein is different from the method proposed by the Agreement, why is it superior?

RESPONSE: This question is unclear, as the NRRI Report does not appear to advocate any particular "proposed method" and states at page 19, "The method the Commission finds most applicable will depend on many factors such as..." The Consumer Advocate is not proposing any "method" that is inconsistent with the HCEI Agreement and will continue to work with the parties in this Docket to find jointly

acceptable approaches that are not unduly complex and that reasonably balance the interests of ratepayers and the utilities.

3. What actions, if any, are required to identify with accuracy each utility's fixed and variable costs?

RESPONSE: In some areas, special studies are required to accurately determine short run fixed versus variable costs. The determination of which utility costs are "fixed" versus "variable" has proven to be controversial in recent rate proceedings involving the HECO Companies. There is general agreement that fuel expenses and the energy component of purchased power charges are variable in both the short and long term. However, non-fuel Production Operations & Maintenance expenses have historically been treated by HECO as "demand" related, as if these costs are relatively fixed. The Consumer Advocate has disputed this cost classification and has asked HECO to perform detailed studies of its Production O&M accounts. In the absence of such studies, HECO has adopted a Consumer Advocate recommendation to employ an FERC "predominance" classification method, as explained by HECO T-22 in pending Docket No. 2008-0083.

3.1. What fixed charges are recovered through the utility's volumetric rates by rate component?

RESPONSE: The rates of the HECO Companies have been established using both cost of service indicators as well as judgments that are sensitive to customer impacts, gradualism, revenue stability, promotion of conservation and other considerations. Existing customer charge rate elements recover a significant portion of estimated monthly customer costs, but no precise quantification is possible because the utilities and the Consumer Advocate have historically disputed how to classify distribution network costs between customer and demand components. It is reasonable to assume that existing volumetric energy rates recover substantial, although not precisely determinable, amounts of utility fixed costs and the amounts of such recovery vary by customer class / rate schedule.

3.2. Is the information needed to allocate costs into fixed and variable costs included in a current rate filing? If yes, please provide.

RESPONSE: The rate case filings that are made by the utilities and the Consumer Advocate contain class cost of service study data that may be useful for this purpose. It would be important to consider the disputes surrounding Production O&M and Distribution network classification in evaluating this data. For examples of the available information from the most recent completed HECO proceeding,

Docket No. 2006-0386, please refer to HECO T-18 and the related Exhibits as well as CA-T-5 and the related Exhibits.

3.3. How should the Commission differentiate between fixed and variable costs?

RESPONSE: There is no need for such differentiation under the full decoupling approach specified in the HCEI Agreement. The Consumer Advocate does not support adoption of a Straight Fixed Variable ("SFV") rate design as an alternative to decoupling.

3.3.1. What timeframe should the Commission consider in setting fixed and variable costs?

RESPONSE: See the Consumer Advocate's response to question 3.3, above.

3.3.2. Are some "fixed costs" simply long-run variable costs that appear fixed in the short term and how should this affect decoupling?

RESPONSE: See the Consumer Advocate's response to question 3.3, above.

3.4. To what extent, if any, should the Energy Cost Adjustment Clause (ECAC) be modified if decoupling is enacted? Are any fixed costs recovered via the ECAC, and if so, should they be removed? To what extent should performance incentives inherent in the clause be modified or removed in order to remove the connection between utility sales and earnings? Should these incentives instead be recovered through the other charges?

RESPONSE: The ECAC does not require modification to implement decoupling in the form proposed in the HCEI Agreement. There is no fixed cost recovery within the existing ECAC. The only performance incentive

within the existing ECAC is the fixed heat rate, which may require adjustment within formal rate case proceedings to consider changes in the mix of resources being utilized by the utility to provide service.

4. What level of specificity is required on a customer's bill to support a decoupling adjustment (e.g., if allocated by rate component, should there be a line item for each part of the decoupling adjustment on the bill)?

RESPONSE: The Consumer Advocate supports the simplicity of a single line on customers' bills reflecting a combined decoupling and RAM rate adjustment. The details of how this charge will be calculated and applied to particular customers or rate classes is under consideration by the parties and was addressed very generally in the Conceptual Framework Proposal that was submitted by the Consumer Advocate on January 30 in this Docket.

5. Do all customers share in the benefits of improved energy efficiency, or only those customers who improve their own energy efficiency?

RESPONSE: The direct, tangible financial benefits of energy efficiency accrue only to those customers who improve their own energy efficiency. Decoupling would serve to increase rates charged to all customers if conservation reduces the kWh sales of the utility, to the clear economic disadvantage of the non-efficient and as an offset to the energy savings otherwise achieved by customers who improve their

own efficiency. There are also assumed to be broader indirect benefits from energy efficiency upon the environment and the overall economy that accrue to everyone without regard to individual efficiency gains.

5.1. What does the allocation of benefits indicate about the allocation of decoupling's earnings adjustments?

RESPONSE: There is no readily available information about how individual customers have achieved energy efficiency that should influence the allocation of decoupling charges among or within customer classes.

5.2. How should the Commission consider each utility's capacity and energy availability in determining the allocation of the decoupling adjustment?

RESPONSE: The Consumer Advocate does not recommend utilization of capacity or energy availability statistics to determine how decoupling charges should be attributed to individual customers or classes of customers.

5.3. Please propose and discuss an allocation methodology for the decoupling methodology proposed at question 2, above. Include responses to the following questions.

RESPONSE: See the Consumer Advocate's response to question 5.2, above.

5.3.1. How much of the anticipated change in sales is driven by utility-sponsored programs? Are the programs available to all classes of customers? How are these costs allocated?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question.

5.3.2. Can the utilities' net metering protocols allow behind-the-meter renewable energy to be tracked as a distinct cause of lost sales?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question.

5.3.3. Does customer growth or attrition mask or exaggerate actual energy efficiency trends?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question.

5.3.4. Aside from utility-sponsored programs, do all classes of customers have the same cost-effective opportunities for energy efficiency improvements?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question.

5.3.5. Can and should the decoupling charge be allocated to promote specific energy efficiency goals such as cutting peak demand or reducing carbon emissions?

RESPONSE: No. The decoupling charge, as discussed by the Consumer Advocate in its Conceptual Framework Proposal that was submitted on January 30 in this Docket, would account for both changes in overall sales margin revenues as well as RAM index-driven changes in authorized revenues within a single charge on customers' bills. This charge would likely grow annually between rate cases and then be "re-based" toward zero in each triennial rate case proceeding. In such form, this rate element would likely not be useful to promote energy efficiency goals. However, application of the combined decoupling/RAM rate element on a per kWh basis to all customers would be generally consistent with a rate design that rewards energy efficiency.

5.3.6. Does energy efficiency offer greater benefits to the economy in one sector than in another?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question.

5.3.7. The utilities contend that some rate classes produce higher rates of return than others do. To the extent that these differences exist, how should they be addressed under the proposed decoupling process?

RESPONSE: The Consumer Advocate recommends that arguments surrounding inter-class cost allocations and the disputes surrounding such allocations (see Consumer Advocate's responses to questions 3.2., above) remain a part of general rate case proceedings and not be allowed to further complicate discussions of decoupling or analyses and implementation of annual decoupling rate adjustments.

6. Should the Commission allow the full recovery of lost earnings through the decoupling adjustment or only some percentage of the calculated lost earnings? How much of the risk associated with a change in sales should remain with the utility?

RESPONSE: The decoupling methodology that the Consumer Advocate has agreed to support in the HCEI Agreement is best described as a version of the "Total sales adjustment" approach described at page 11 of the NRRI Report. This approach transfers 100 percent of the risk associated with a change in sales from the utility to ratepayers.

6.1. If there is a deviation from 100% recovery, should the deviation be symmetric? For example if sales decrease, does the utility receive 75% of the calculated lost earnings but when sales increase, customers get 100% of the adjustment?

RESPONSE: See the Consumer Advocate's response to question 6, above.

6.2. How does a partial adjustment help meet the goals of the Clean Energy Initiative?

RESPONSE: See the Consumer Advocate's response to question 6, above.

7. How much, if any, of a rate-of-return adjustment is commensurate with the greater certainty in earnings provided by decoupling?

RESPONSE: As discussed in the response to question 6, the proposed approach as described in the HCEI Agreement essentially transfers 100% of the risk associated with a change of sales to ratepayers. Thus, it is reasonable to assume that there should be some downward adjustment to any Commission authorized rate of return as compared to a utility company that does not have a similar decoupling and RAM in place.

At this time, while the Consumer Advocate contends that additional studies and analyses must be conducted, the Consumer Advocate offers, as a preliminary estimate, that a 25 basis point reduction in the cost of equity would be a possible placeholder until those studies and analyses can be conducted.

7.1. To the extent that decoupling results in less financial risk for the utility, how should the commission quantify that effect and how should this be flowed through to the utility's rate of return?

RESPONSE: Assuming that there is agreement that the proposed approach reduces the shareholders' risk by transferring all of the risk associated with any change in sales to ratepayers, this reduction in

risk can be reflected in the calculated cost of equity. The quantification of the adjustment to the cost of equity would necessitate the appropriate acknowledgements in any analysis, such as in the determination of the comparable sample companies.

7.2. Please quantify decoupling's effect on the utilities' "beta" (a measurement of risk) and what that means to the utility's return and ability to move to a capital structure with more debt.

RESPONSE: Until the exact implementation of decoupling and RAM is approved by the Commission, any quantification of an impact on the utilities' "beta" would be premature. As discussed above, though, as is currently proposed, the risks to the shareholders' are reduced, thus, it is likely that the observed beta should decrease. As the risk associated with any investment vehicle decreases, it is generally accepted that investors' expectations regarding the return on that investment correspondingly decreases.

The Consumer Advocate is not able to respond to regarding the ability to move to a capital structure with more debt since that appears to be a decision that would be made somewhat independent of decoupling and would require consideration of a number of factors unassociated with decoupling.

7.3. Can input from the rating agencies be included during development of the decoupling process?

RESPONSE: The Consumer Advocate assumes that, if the Commission orders that input from the rating agencies should be solicited during the development of the decoupling process, the appropriate steps will be taken to accumulate the necessary data and input from the rating agencies, if possible.

8. Some customers may not have the same opportunity to conserve electricity as other customers because differences such as income, access to capital, age, and renting versus owning. How should decoupling adjustments be structured to address this lesser ability to conserve?

RESPONSE: These issues are probably better addressed within the Lifeline Rates provisions of the HCEI Agreement. Decoupling and RAM adjustments are sufficiently complex without burdening these mechanisms with such intended distinctions among individual customers' circumstances.

9. Please propose a customer education program for the decoupling mechanism proposed at question 2 and the allocation methodology proposed at 5.2.

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis for any customer education program proposals at this time. The parameters of the decoupling/RAM mechanism must first be established before customer education considerations can be addressed.

10. To the extent that the decoupling mechanism is intended to help reduce energy consumption, can this adversely affect the state's efforts to incorporate more as-available renewable energy into the grid? Can reduced consumption cause more instances where as-available energy must be curtailed due to the utility's system constraints?

RESPONSE: The Consumer Advocate has no information and has conducted no studies that would serve as the basis of a succinct response to this question

11. Do the rate changes associated with the decoupling mechanism merit a new rate case for HECO pursuant to Hawaii Revised Statutes, Chapter 269, or can the changes be accomplished within the scope of the existing HECO rate case? Are public hearings needed, considering the extent of the expected rate changes?

RESPONSE: Pursuant to Hawaii Revised Statutes ("HRS"), Chapter 269, arguably, any modifications to an approved utility rate, with the exception of automatic rate adjustment charges, must be approved through a contested case proceeding with appropriate public notice. The initial determination of a decoupling mechanism and related rate change should merit a rate case proceeding under the authorizing statute. Annual adjustments, however, should be determined through a non-traditional or informal Commission review and approval process more akin to the automatic rate adjustments in order to provide expedient or intended rate relief.

Consistent with the discussion above, establishing significant rate changes due to a newly determined decoupling mechanism

would appear to require the notice requirement pursuant to HRS §§ 269-12 and 269-16.

12. Various provisions of the HCEI propose utility surcharges, where the utility will fairly immediately recover its costs (potentially both fixed and variable) through a surcharge that is separate from the normal rates. How can the commission effectively decouple this aspect of the utility rates? Do these surcharges impact the effectiveness of the efforts to decouple rates from earning?

RESPONSE: In its Conceptual Framework Proposal submitted on January 30, the Consumer Advocate recommended a trial implementation for only a very conservatively scoped and carefully administered decoupling/RAM mechanism. In addition, the Consumer Advocate's Conceptual Framework included an earnings sharing constraint due in large measure to concerns about excessive cumulative cost recovery pursuant to rate cases, decoupling adjustments, RAM adjustments and the various other CEI Surcharges that are enabled by the HCEI Agreement.

- 12.1 Please provide details of changes that need to be made to the various HCEI proposals that have already been filed as a result of decoupling.

RESPONSE: The Consumer Advocate continues to work with the HECO Companies and other parties in Docket No. 2008-0274, in an effort to find consensus surrounding the many important details involved in implementing the prescribed decoupling and RAM rate adjustments in a manner consistent with the various HCEI

Agreement provisions -- while also satisfying the public interest in just and reasonable utility rates. Our recommended changes can be identified by comparing the Consumer Advocate's Conceptual Framework Proposal submitted on January 30 to the Company's filing on that date.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S RESPONSES TO THE NATIONAL REGULATORY RESEARCH INSTITUTE'S SCOPING PAPER APPENDIX 2 QUESTIONS FOR THE PARTIES** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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